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FISCAL IMPACT STATEMENT

LS 7315 **NOTE PREPARED:** Jan 5, 2011
BILL NUMBER: HB 1191 **BILL AMENDED:**

SUBJECT: Taxation of Civil Service Annuities.

FIRST AUTHOR: Rep. Clere **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X **GENERAL** **IMPACT:** State & Local
DEDICATED
FEDERAL

Summary of Legislation: This bill increases the civil service annuity income tax deduction from $2,000 to $5,000. It establishes a subsequent trigger date to increase the deduction from $5,000 to $13,000 over a three year phase-in period. It provides that the deduction is available to a surviving spouse. The bill also repeals the current civil service annuity income tax deduction provision.

Effective Date: January 1, 2011 (retroactive).

Explanation of State Expenditures: *Department of State Revenue (DOR)*: The DOR would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to reflect the increases in the income tax deduction for civil service annuities. The DOR's current level of resources should be sufficient to implement the change.

Explanation of State Revenues: *Summary* - The bill would reduce Adjusted Gross Income (AGI) Tax liabilities of certain individual taxpayers who receive federal civil service retirement benefits, including surviving spouses. The bill increases the deduction from $2,000 to $5,000 in tax year 2011, which would likely reduce revenue to the state General Fund by approximately $345,000. The revenue loss attributable to the phase-in of the deduction from $5,000 to $13,000 is provided in the table below. The potential revenue losses due to these increases in the deduction are in addition to the revenue losses occurring under the current deduction limits.

Deduction Amount	Additional Revenue Loss
$5,000	$0.3 M
$8,000	$0.7 M
$11,000	$1.0 M
$13,000	$1.2 M

The fiscal impact of the initial deduction increase from $2,000 to $5,000 would begin in FY 2012. The fiscal impact of the potential phase-in from $5,000 to $13,000 will depend upon when the surplus date occurs, which will trigger the phase-in of the increase in the deduction. The bill defines "surplus date" as the first state fiscal year, after 2011, in which the year-end general revenue fund balance for the immediately preceding state fiscal year exceeds 10% of the general revenue fund appropriations for the current state fiscal year. If recent trends persist, the annual revenue loss after the phase-in is complete could potentially decline by about 1.3% to 1.9% annually. The impact of extending the deduction to a surviving spouse could potentially increase the revenue loss from the bill, but the extent of the impact is unknown.

Background Information - Under current statute, taxpayers may deduct up to $2,000 in civil service annuity income. The deduction is equal to the difference between $2,000 and the total amount of Social Security and railroad benefits received by the taxpayer. Based on the current deduction limits, revenue loss for FY 2012 is estimated to be approximately $230,000. State tax return data indicates that 4,159 taxpayers deducted approximately $7.1 M in civil service annuity pay from AGI in 2008. This amount resulted in a revenue loss of about $240,000. From 2003 to 2008, this deduction declined by an average of 1.3% per year.

Data from the U.S. Office of Personnel Management indicates that there were about 25,000 federal retirees and about 8,000 surviving spouses of federal retirees residing in Indiana in 2009. These individuals received $805 M in civil service annuity payments during 2009, with the average annuity to retirees equal to about $27,000. The average survivor's benefit was about $15,000. The total payments to retirees and their spouses in Indiana increased, on average, 4% over the past 10 years.

The bill increases the deduction beginning in tax year 2011; thus, the fiscal impact of the phase-in will commence in FY 2012. Revenue collected from the AGI tax on individuals is deposited in the state General Fund.

Explanation of Local Expenditures:

Explanation of Local Revenues: Because the increase in the civil service retirement deduction would serve to decrease taxable income, counties imposing local option income taxes could potentially experience a minimal decrease in revenue from these taxes.

State Agencies Affected: DOR.

Local Agencies Affected: Counties with local option income taxes.

Information Sources: OFMA Income Tax Databases, 1996-2008; Lynn Wehner, U.S. Office of Personnel Management.

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